

EXHIBIT 7

**THE METROPOLITAN SEWER DISTRICT
OF GREATER CINCINNATI**

FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

December 31, 1997

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TABLE OF CONTENTS**

	PAGE
Independent Auditors' Report	
Financial Statements	
Balance Sheets	1
Statements of Revenues, Expenses and Changes in Fund Equity	2
Statements of Cash Flows	3
Notes to the Financial Statements	4-16
Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with <u>Government Auditing Standards</u>	17-18
Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133	19-20



VONLEHMAN & COMPANY INC.

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INDEPENDENT AUDITORS' REPORT

The Honorable Board of County Commissioners
The Metropolitan Sewer District of Greater Cincinnati
County of Hamilton, Ohio

We have audited the balance sheets of The Metropolitan Sewer District of Greater Cincinnati (MSD), a component unit of the County of Hamilton, Ohio, as of December 31, 1997 and 1996, and the related statements of revenues, expenses and changes in fund equity, and cash flows for the years then ended. These financial statements are the responsibility of MSD's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standard is applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Metropolitan Sewer District of Greater Cincinnati, at December 31, 1997 and 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued a report dated April 27, 1998 on our consideration of The Metropolitan Sewer District of Greater Cincinnati's internal control structure and a report dated April 27, 1998 on its compliance with laws and regulations.

VonLehman & Company Inc.

Fort Mitchell, Kentucky
April 27, 1998

LIABILITIES AND EQUITY

	December 31,	
	1997	1996
Current Liabilities		
Current Portion of Long-Term Debt	\$ 13,132	\$ 9,250
Accounts Payable	4,546	3,573
Accrued Payroll Expenses	1,430	1,271
Total Current Liabilities	<u>19,108</u>	<u>14,094</u>
Payable from Restricted Assets		
Construction Accounts Payable	3,351	3,863
Accrued Interest	1,704	1,303
Total Payable from Restricted Assets	<u>5,055</u>	<u>5,166</u>
Long-Term Liabilities		
Accrued Compensated Absences	5,451	5,413
Long-Term Debt (Net of Deferred Loss on Refunding Bonds of \$444 in 1997 and \$574 in 1996)	392,170	295,581
Total Long-Term Liabilities	<u>397,621</u>	<u>301,004</u>
Total Liabilities	<u>421,784</u>	<u>320,323</u>
Equity		
Contributions in Aid of Construction	170,626	173,113
Retained Earnings	196,518	190,214
Total Equity	<u>367,144</u>	<u>363,327</u>
Total Liabilities and Equity	<u>\$ 788,928</u>	<u>\$ 683,650</u>

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
BALANCE SHEETS
(amounts expressed in thousands)

ASSETS

	December 31,	
	1997	1996
Current Assets		
Cash and Cash Equivalents	\$ 11,728	\$ 11,786
Accounts Receivable	17,399	19,035
Prepaid Expenses and Other	2,452	3,307
Total Current Assets	31,579	34,128
Restricted Assets		
Cash and Cash Equivalents Held by the City of Cincinnati	9,115	5,246
Construction Account	14,235	10,988
Amount to be Transferred to Surplus Account		
Investments Held by Trustee	1,831	846
Cash and Cash Equivalents	145,765	66,583
Investments - Held to Maturity		
Total Restricted Assets	170,946	83,663
Property, Plant and Equipment		
Land	4,925	4,282
Buildings and Structures	533,684	468,292
Processing Systems	216,678	216,726
Office and Service Equipment	22,381	20,934
Construction in Progress	73,099	97,669
Accumulated Depreciation		
	850,767	807,903
	(275,911)	(254,168)
Total Property, Plant and Equipment	574,856	553,735
Other Assets		
Unamortized Financing Costs	8,402	8,241
Settlements Receivable	3,145	917
Other		3,101
Total Other Assets	11,547	12,259
Total Assets	\$ 788,928	\$ 683,785

LIABILITIES AND EQUITY

	December 31,	
	1997	1996
Current Liabilities		
Current Portion of Long-Term Debt	13,132	\$ 9,250
Accounts Payable	4,546	3,576
Accrued Payroll Expenses	1,430	1,271
Total Current Liabilities	19,108	14,097
Payable from Restricted Assets		
Construction Accounts Payable	3,351	3,866
Accrued Interest	1,704	1,306
Total Payable from Restricted Assets	5,055	5,174
Long-Term Liabilities		
Accrued Compensated Absences	5,451	5,476
Long-Term Debt (Net of Deferred Loss on Refunding Bonds of \$444 in 1997 and \$574 in 1996)	392,170	295,581
Total Long-Term Liabilities	397,621	301,057
Total Liabilities	421,784	320,328
Equity		
Contributions in Aid of Construction	170,626	173,173
Retained Earnings	196,518	190,284
Total Equity	367,144	363,457
Total Liabilities and Equity	\$ 788,928	\$ 683,785

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENTS OF REVENUES, EXPENSES
AND CHANGES IN FUND EQUITY
(amounts expressed in thousands)

	Years Ended December 31,	
	1997	1996
Operating Revenues		
Sewerage Service Charges	\$ 88,504	\$ 90,183
Sewerage Surcharges	11,422	11,523
Other Revenues	2,462	2,743
Total Operating Revenues	102,388	104,463
Operating Expenses		
Personnel Services	35,397	35,773
Utilities, Fuel and Supplies	14,160	14,183
Depreciation and Amortization	23,859	21,743
Purchased Services	16,192	13,965
Other Expenses	3,829	3,133
Total Operating Expenses	93,437	88,803
Income from Operations	8,951	15,660
Other Income (Expense)		
Interest Income	5,806	5,792
(Loss) Gain on Disposal of Property, Plant and Equipment	(49)	353
Interest Expense	(16,367)	(15,262)
Total Other Income (Expense)	(10,610)	(9,083)
Net (Loss) Income	(1,659)	6,583
Amortization of Contributions in Aid of Construction	7,893	7,700
Retained Earnings at Beginning of Year	190,284	176,004
Retained Earnings at End of Year	196,518	190,284
Contributions in Aid of Construction at Beginning of Year	173,173	174,634
Additions to Contributions in Aid of Construction	5,346	6,239
Amortization of Contributions in Aid of Construction	(7,893)	(7,700)
Contributions in Aid of Construction at End of Year	170,626	173,173
Total Fund Equity at End of Year	\$ 367,144	\$ 363,417

See auditors' report and accompanying notes.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENTS OF CASH FLOWS
(amounts expressed in thousands)

	Years Ended December 31,	
	1997	1996
Cash Flows from Operating Activities		
Cash Received from Customers	\$ 101,663	\$ 99,569
Cash Payments for Goods and Services	(33,501)	(31,996)
Cash Payments for Personnel Costs	(35,264)	(35,385)
Other Operating Revenues	3,931	2,309
Net Cash Provided by Operating Activities	36,829	34,497
Cash Flows from Capital and Related Financing Activities		
Proceeds from Sale of Revenue Bonds	105,245	-
Revenue Bonds Issuing Cost	(387)	-
Principal and Interest Payments on Long-Term Debt	(24,458)	(21,938)
Acquisition and Construction of Capital Assets	(35,072)	(48,097)
Proceeds from Sale of Property, Plant and Equipment	193	390
Net Cash Provided (Used) by Capital and Related Financing Activities	45,521	(69,645)
Cash Flows from Investing Activities		
Purchase of Government Securities	(383,087)	(162,944)
Maturity or Redemption of Government Securities	303,773	185,426
Interest Earned on Investments	5,093	6,997
Trustee Fees	(86)	(59)
Net Cash (Used) Provided by Investing Activities	(74,307)	29,420
Net Change in Cash and Cash Equivalents	8,043	(5,728)
Cash and Cash Equivalents at January 1	28,866	34,594
Cash and Cash Equivalents at December 31	\$ 36,909	\$ 28,866
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Income from Operations	\$ 8,951	\$ 15,660
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation	22,933	20,837
Amortization	926	906
Allowance for Doubtful Accounts	280	300
Change in Assets and Liabilities:		
Net Change in Customer Accounts Receivable	1,457	(2,445)
Net Change in Other Receivable	1,468	(440)
Net Change in Prepaid Expenses	133	(1,412)
Net Change in Operating Accounts Payable	(290)	393
Net Change in Accrued Payroll and Related Expenses	971	698
Net Cash Provided by Operating Activities	\$ 36,829	\$ 34,497
Noncash Investing and Financing Transactions		
Amounts Received in as Partial Payment for Settlement Receivable	\$ 916	\$ -
Loans Incurred for Construction	4,260	3,579
Structures Acquired as Contributed Capital in Aid of Construction	5,346	3,999
Total Noncash Investing and Financing Transactions	\$ 10,522	\$ 7,578

See auditors' report and accompanying notes.

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
NOTES TO THE FINANCIAL STATEMENTS**

NOTE 1 - ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the accompanying financial statements follow :

Organization

The Metropolitan Sewer District of Greater Cincinnati (MSD), a component unit of the County of Hamilton, Ohio, collects and treats industrial and residential wastewater for municipalities and unincorporated areas of Hamilton County. MSD was established pursuant to an agreement dated May 1, 1968 between the Board of Commissioners of Hamilton County and the City of Cincinnati. Under a contract with the City of Cincinnati, the Board designated the City as its agent for the maintenance and operation of MSD. The annual budget, prepared on the cash basis of accounting, is approved by the Board and administered by the City. Budgetary control is exercised at the divisional level, and between personnel and all other costs.

Basis of Accounting

The accompanying financial statements were prepared on the accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred.

Enterprise Fund Activity Accounting and Financial Reporting

Enterprise funds and similar component units apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Investments

MSD is required by Ohio law to invest in only United States obligations; federal agency securities; Ohio bonds and other obligations or such obligations of political subdivisions of the state, provided that the subdivisions are located within Hamilton County; time certificates of deposit or deposit accounts in an eligible institution; and no load money market mutual funds consisting only of investments mentioned above. Investments are required to mature within five years from the date of settlement, unless the investment is matched to a specific obligation or debt of MSD.

Investment securities are stated at cost, adjusted for amortization of premiums and accretion of discount on purchases. Amortization and accretion is by the straight-line method over the term of the investment. Any differences between amortization or accretion by the straight-line method versus the interest method are immaterial.

NOTE 1 - ACCOUNTING POLICIES (Continued)

Inventory

Supplies and materials are stated at the lower of cost or market on a first-in, first-out (FIFO) basis.

Property, Plant and Equipment

Property, plant and equipment are stated at historical cost for assets acquired after MSD's inception in 1968. Assets which were acquired prior to 1968 and not identifiable with specific historical costs are not included in the property, plant and equipment balance. Assets acquired by MSD through contributions, such as contributions from land developers and federal and state grants, are capitalized and recorded in the plant records at the contributors' reported cost. Construction costs include interest capitalized on debt during the period of construction and the cost of in-force labor.

Depreciation expense is computed on the straight-line method over the estimated useful lives of the respective assets. The estimated lives are as follows:

Building and Structures	40 Years
Processing Systems	25 Years
Office and Service Equipment	5 - 15 Years

Depreciation expense on property, plant and equipment acquired through contributions is reported as an offset against contributions in aid of construction in fund equity. Any gain or loss arising from the disposal of property, plant and equipment has been credited or charged to income.

Unamortized Financing Costs

The unamortized financing costs include bond discount, consulting and attorney fees incurred in connection with the revenue bond obligations. These amounts are being amortized on the interest method and the straight-line method, respectively, over the lives of the revenue bonds.

Pension Plans

Employees participate in either the City of Cincinnati's Retirement System or the Public Employees Retirement System administered by the State of Ohio. Pension costs reflect a percentage of employees' gross pay, as defined by the terms of pension plans in which employees participate. MSD's policy is to fund pension costs accrued.

Claims Liabilities

MSD records an estimated liability for indemnity health care, workers' compensation, torts and other claims against them. Claims liabilities are based on estimates of the ultimate cost of reported claims (including future claim adjustment expenses) and an estimate for claims incurred but not reported based on historical experience. Claims liabilities include specific, incremental claim adjustment expenses, allocated loss adjustment expenses, and are reduced for estimated recoveries on unsettled claims such as salvage or subrogation.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**NOTE 1 - ACCOUNTING POLICIES (Continued)****Compensated Absences**

Compensated absences are accrued in accordance with Statement No. 16 issued by the Governmental Accounting Standards Board. Components of the liability include accrued vacation time, sick leave, compensatory time and other related payments.

NOTE 2 - CASH AND CASH FLOW INFORMATION

For purposes of the Statements of Cash Flows, all highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

NOTE 3 - CASH AND INVESTMENTS

Cash and investments consist of the following:

	December 31,			
	1997		1996	
(in thousands)	Cash and Cash Equivalents	Investments	Cash and Cash Equivalents	Investments
Amounts held by City of Cincinnati	\$35,078	\$ -	\$28,020	\$ -
Investments held by Trustees:				
Reserve	950	32,102	841	27,652
Replacement and Improvement Expense Fund	1	4,938	1	4,948
Bond Retirement	26	-	-	-
Surplus	1	3,063	2	2,213
	<u>853</u>	<u>105,662</u>	<u>2</u>	<u>31,770</u>
Total cash and investments	<u>\$36,909</u>	<u>\$145,765</u>	<u>\$28,866</u>	<u>\$66,583</u>

The amounts held by the City of Cincinnati (the City) are invested on MSD's behalf in accordance with the Cincinnati Municipal Code. These amounts are collateralized as part of the City's cash and investment balances. Bank balances of the City are covered by Federal depository insurance or collateral held by the Cincinnati Branch of the Federal Reserve Bank of Cleveland or the City's agent in the City's name.

Investments held by trustees are eligible investments as defined by the Trust Agreement and are registered in the name of the trustee for the benefit of MSD.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**NOTE 3 - CASH AND INVESTMENTS (Continued)**

Investments made by the City are summarized below. The investments that are represented by specific identifiable investment securities are classified as to credit risk by the three categories described below.

Category 1 - Insured or registered, or securities held by the City or its agent in the City's name.

Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the City's name.

Category 3 - Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent, but not in the City's name.

(In Thousands)	<u>1</u>	<u>Category</u> <u>2</u>	<u>3</u>	<u>Carrying</u> <u>Amount</u>	<u>Market</u> <u>Value</u>
<u>December 31, 1997</u>					
U. S. Government Securities	<u>\$145,765</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$145,765</u>	<u>\$146,727</u>
Total Investments	<u>\$145,765</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$145,765</u>	<u>\$146,727</u>
<u>December 31, 1996</u>					
U. S. Government Securities	<u>\$66,583</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$66,583</u>	<u>\$66,012</u>
Total Investments	<u>\$66,583</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$66,583</u>	<u>\$66,012</u>

NOTE 4 - ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following:

	<u>December 31,</u> <u>(in thousands)</u>	
	<u>1997</u>	<u>1996</u>
Sewerage charges and surcharges:		
Unbilled amount	\$ 9,168	\$ 9,639
Billed amount	8,692	9,679
Less allowable for doubtful accounts	(1,500)	(1,220)
Other	<u>1,039</u>	<u>937</u>
Total	<u>\$17,399</u>	<u>\$19,035</u>

NOTE 5 - RESTRICTIONS ON ASSETS

Land acquired for MSD's use is titled to either the City of Cincinnati or Hamilton County. The cost of this land has been recorded on the books of MSD since it has the full benefits of the land as an economical resource.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI

NOTE 5 - RESTRICTIONS ON ASSETS (Continued)

In August 1985, the Federal District Court entered a consent order in an action with MSD and others (see Commitments and Contingencies Note). In complying with the consent order, MSD is required to maintain amounts on deposit in an environmental security account. Expenditures from this account must be approved by the U.S. Environmental Protection Agency. The balance of this account, which is included in other assets, was \$947,000 and \$902,000 at December 31, 1997 and 1996, respectively.

The Trust Agreement for the Series A Revenue Bonds (see Long-Term Debt Note) requires the establishment of certain trust accounts including a Bond Account, Bond Reserve Account, Replacement and Improvement Account, and a Surplus Account to be held by the Trustee. The Bond Account will be used to accumulate periodic principal and interest payments. The Bond Reserve Account will be funded in an amount equal to the highest annual future debt service requirement. The Replacement and Improvement Account will be maintained with a balance of \$5,000,000. The Surplus Account is available to be used for any other Sewer System purpose. The Trust Agreement also requires the creation of a Construction Account to be held by the City to pay for project costs.

NOTE 6 - LONG-TERM DEBT

Long-term debt consisted of the following:

(in thousands, except percents)

	Principal Issue	Interest Rate	Year of Maturity	December 31,	
				1997	1996
Series A Revenue Bonds					
1997	\$105,245	3.85-5.14	2017	\$105,245	\$ -
1995	85,800	3.70-6.05	2017	81,660	84,130
1993	171,790	2.45-5.60	2016	165,415	166,230
1991	90,950	4.80-6.70	2013	33,495	37,840
Loveland Sewer District	200	5.75	2000	30	40
Ohio Water Development Authority Contracts	41,830	2.00-7.49	2019	5,953	7,080
Ohio Water and Sewer Rotary Commission	-	-	-	124	124
Ohio Public Works Commission	-	0.00-3.00	2017	3,091	2,203
Water Pollution Control Loan Fund - Construction	-	3.54-4.80	2018	10,710	7,686
Drawdown	-	7.35	1998	23	72
Capital Lease	293				
Total Obligations				405,746	305,405
Less Current Maturities				13,132	9,250
Long-Term Portion				392,614	296,155
Less Deferred Loss on Refunding				444	574
Long-Term Portion				<u>\$392,170</u>	<u>\$295,581</u>

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**NOTE 6 - LONG-TERM DEBT (Continued)**

Principal payments on long-term debt for the next five years and thereafter are as follows:

	(in thousands)
1998	\$ 13,132
1999	13,794
2000	14,442
2001	14,803
2002	14,964
Thereafter	<u>334,611</u>
Total	<u>\$405,746</u>

Series A Revenue Bonds

Effective October 22, 1997, MSD issued \$105,245,000 County of Hamilton, Ohio 1997 Series A Sewer System Improvement Revenue Bonds dated October 1, 1997. The proceeds from the 1997 bonds were used to permanently fund certain previous expenditures, fund the new bond reserve requirement and pay the cost of issuance. The 1997 bonds are special obligations of the District, payable solely from the net revenues of the District and are issued on a parity with the 1991, 1993, and 1995 Series A bonds, secured equally and ratably under the Trust Agreement.

Effective August 31, 1995, MSD issued \$85,800,000 County of Hamilton, Ohio 1995 Series A Sewer System Improvement and Refunding Revenue Bonds dated August 15, 1995. The proceeds from the 1995 bonds were used to permanently fund certain previous capital expenditures, provide funds for new projects, defease a portion of the 1986 and 1991 Series A bond issues, fund the new bond reserve requirement and pay the cost of issuance. The 1995 bonds are special obligations of the District payable solely from the net revenues of the District and are issued on a parity with the 1991 and 1993 Series A bonds, secured equally and ratably under the Trust Agreement.

Effective May 4, 1993, MSD issued \$171,790,000 County of Hamilton, Ohio 1993 Series A Sewer System Improvement and Refunding Revenue Bonds dated April 15, 1993. The proceeds from the 1993 Bonds were used to permanently fund certain previous capital expenditures, provide funds for new projects, defease a portion of the 1986 and 1991 Series A bond issues, fund the new bond reserve requirement, and pay the cost of issuance. The 1993 bonds are special obligations of the District payable solely from the net revenues of the District and are issued on a parity with the 1991 Series A bonds, secured equally and ratably under the Trust Agreement.

Effective February 26, 1991, MSD issued \$90,950,000 County of Hamilton, Ohio, 1991 Series A Sewer System Improvement and Refunding Revenue Bonds dated January 15, 1991. The proceeds from the 1991 Bonds were used to permanently fund certain previous capital expenditures, provide funds for new projects, defease a portion of the 1985 Series A bond issue, fund the new bond reserve requirement, and pay the cost of issuance.

The 1997, 1995, 1993 and 1991 Bonds may be redeemed prior to their maturities in accordance with provisions of the bond resolutions. The redemption prices for the bonds include declining premiums up to 3 percent of principal.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**NOTE 6 - LONG-TERM DEBT (Continued)**

Maturities for bonds over the next five years and thereafter are shown below.

	(in thousands)			
	1997	1995	1993	1991
	<u>Bonds</u>	<u>Bonds</u>	<u>Bonds</u>	<u>Bonds</u>
1998	\$ 3,270	\$ 2,570	\$ 845	\$ 4,605
1999	3,420	2,685	885	4,875
2000	3,570	2,800	930	5,175
2001	3,730	5,095	975	3,325
2002	3,900	3,920	2,440	3,530
Thereafter	<u>87,355</u>	<u>64,590</u>	<u>159,340</u>	<u>11,985</u>
	<u>\$105,245</u>	<u>\$81,660</u>	<u>\$165,415</u>	<u>\$33,495</u>

Under the terms of the amended revenue bond trust indenture, MSD has agreed to certain covenants, among other things, to restrict additional borrowing, fix and maintain rates sufficient to meet debt service requirements, and maintain specified fund balances under trust agreements.

The Revenue Serial bond issues as discussed above contain covenants which require the District to maintain a level of debt service coverage. The following calculation reflects the District's debt service coverage.

	<u>1997</u>		<u>1996</u>
	(in thousands)		
Revenues:			
Total operating revenues	\$102,388		\$104,463
Interest Income	5,806		5,792
Capitalized Interest Income	569		1,072
Tap-in / Connection Fees	<u>3,018</u>		<u>2,239</u>
Total pledge revenues	111,781		113,566
Total operating and maintenance expenses			
less depreciation and amortization	(69,578)		(67,060)
Half of Pledged Revenues Transferred to Surplus Account	<u>7,118</u>		<u>5,494</u>
Net income available for debt service	<u>\$49,321</u>	(a)	<u>\$ 52,000</u>
Principal and Interest Requirements on Revenue Bonds	<u>\$23,886</u>	(b)	<u>\$ 23,328</u>
Principal and interest requirements on all obligations	<u>\$26,083</u>	(c)	<u>\$ 25,884</u>
Debt Service Coverage:			
Revenue Bonds (a) divided (b)	<u>2.06</u>		<u>2.23</u>
All Obligations (a) divided (c)	<u>1.89</u>		<u>2.01</u>
Basic coverage required on bonds	<u>1.25</u>		<u>1.25</u>

NOTE 6 - LONG-TERM DEBT (Continued)**Loveland Sewer District**

Sewer Improvement Bonds in the amount of \$200,000 were issued by the City of Loveland in 1974. MSD assumed this debt upon merger of the Loveland Sewer District into MSD in March, 1985.

Ohio Water Development Authority Contracts

All contracts between the Ohio Water Development Authority (OWDA) and the Metropolitan Sewer District require MSD to prescribe and charge such rates for sewer usage which are sufficient (after expenses of operation and maintenance) to pay principal and interest on OWDA contracts. The principal is repayable in equal semi-annual installments to maturity.

Tap-in / Connection Fees

Tap-in / connection fees were increased in 1996. The typical single-family home increased from \$480 to \$2,500. This change meets the criteria for revenue to be recognized as a contribution of capital by the property owner instead of expense recovery as in prior years.

Ohio Water and Sewer Rotary Commission

Advances from Ohio Water and Sewer Rotary Commission represent tap-in fees and acreage assessments to be forwarded to the Commission upon collection from customers. Such advances do not bear interest unless they are determined to be in default.

Ohio Public Works Commission

The MSD has entered into agreements with the Ohio Public Works Commission (OPWC) for financing of certain qualified capital projects. As the projects progress the commitments are drawn down as funds are paid by OPWC directly to the contractors. The principal is repayable in semi-annual installments to the date of maturity for each project.

Water Pollution Control Loan Fund

The MSD has received low interest loan commitments from the Ohio Water Pollution Control Loan Fund for certain qualified projects. As the projects progress the commitments are drawn down.

Capital Lease

A five year lease/purchase agreement for communication equipment commenced in 1993 with monthly payments of \$4,661 to 1998.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**NOTE 6 - LONG-TERM DEBT (Continued)****Interest on Long-Term Obligations**

The following interest costs were incurred and expensed or capitalized as part of the cost of MSD's additions to property, plant, and equipment.

	(in thousands)	
	<u>1997</u>	<u>1996</u>
Interest Incurred	\$17,971	\$ 17,868
Less Interest Capitalization	<u>(1,604)</u>	<u>(2,606)</u>
Interest Expense	<u>\$16,367</u>	<u>\$ 15,262</u>

NOTE 7 - DEFEASED DEBT**Other Defeasance**

In prior years, MSD defeased various general obligation serial bonds and revenue serial bonds through refinancing and operations. Separate irrevocable trust funds were established and funded to fully service the defeased debt until the debt is called or matures. For financial reporting purposes, the debt has been considered defeased and is not included in the financial statements. At December 31, 1997 and 1996, the amount of prior year's defeased debt outstanding amounted to \$45,421,000 and \$46,416,000, respectively.

NOTE 8 - CONTRIBUTIONS IN AID OF CONSTRUCTION

Contributions have been received from the OWDA and the United States Government in accordance with agreements transacted between MSD and these two entities. The City of Cincinnati and Hamilton County provided working capital to MSD upon formation, and those capital contributions are included in the amounts below. Other contributions have been received in connection with the expansion of sewerage services.

Net contributions in aid of construction consisted of the following:

	<u>December 31,</u>	
	<u>1997</u>	<u>1996</u>
	(in thousands)	
United States Government Grants	\$129,722	\$129,722
City of Cincinnati	68,356	68,356
Ohio Water Development Authority Grants	46,197	45,901
Customers	73,879	68,829
Hamilton County	<u>1,738</u>	<u>1,738</u>
	319,892	314,546
Less accumulated amortization of contributions in aid of construction	<u>(149,266)</u>	<u>(141,373)</u>
	<u>\$170,626</u>	<u>\$173,173</u>

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**NOTE 9 - PENSION AND RETIREMENT**

All MSD full-time employees participate in either the Retirement System of the City of Cincinnati (City System) or the Public Employees' Retirement System administered by the State of Ohio (State PERS). Each plan is a cost-sharing, multiple-employer, defined benefit, public employee retirement system.

The payroll for employees covered by the plans for the year ended December 31, 1997, was \$27,117,000 and \$1,009,000 for the City System and State PERS, respectively. MSD's total payroll was \$28,126,000. The payroll for employees covered by the plans for the year ended December 31, 1996, was \$26,808,000 and \$1,002,000 for the City System and State PERS, respectively. MSD's total payroll for 1996 was \$27,810,000.

Income sources for each pension system include both employee and employer contributions as well as income earned on investments. Employer contributions to the pension funds are current and fully met as required by law. Annual contributions to all pension systems include a provision for past service costs to properly fund pension and other benefits payable on account for creditable service. Each pension system is evaluated annually by a nationally recognized actuarial consultant.

The following table lists the employer and employee contribution rates and amounts paid by MSD for each retirement system for the year ended December 31, 1997.

	(in thousands, except percents)			
	<u>Employer</u>		<u>Employee</u>	
	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>
City of Cincinnati Retirement System	18.90	\$5,095 *	7.0	\$1,898
Public Employees Retirement System	13.55	137 **	8.5	86

* Employer amount includes health care costs which were included in the calculation of the pension benefit obligation.

** A portion of the PERS employer amount is used to fund a health care program which is not part of pension benefit obligation calculations.

City of Cincinnati Retirement System

The service retirement allowance vests after five years of creditable service. Medical care benefits vest after fifteen years of creditable service or after reaching age sixty with five years of creditable service. Any member in service may retire upon attaining age sixty, regardless of length of membership service if he was enrolled prior to January 1, 1969, or with a least five years of membership service if enrollment occurred at January 1, 1969, or later; or upon completing five years of creditable service before age sixty members may retire with a retirement allowance commencing at age sixty, provided, however, at the time of election of the deferred annuity there is no loan outstanding against his contributions; or upon completing thirty or more years of membership service at any age, with a retirement allowance commencing immediately.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**NOTE 9 - PENSION AND RETIREMENT (Continued)**

The annual retirement allowance consists of an annuity provided by the number equal in value to contributions with interest at the time of retirement and a pension, which together with annuity, produces a total annual retirement allowance equal to 2 percent of the average of the three highest years' compensation multiplied by the number of years of membership service. Pensions are increased by 3% per year commencing two years after retirement. The System also provides death and disability benefits. These benefit provisions and all other requirements are established by the Cincinnati Municipal Code.

Each member contributes at a rate of seven percent (7%) of his salary until his retirement. The rate of contribution is fixed by the fund's Board of Trustees on the basis of authority provided by Chapter 203, Section 77, of the Cincinnati Municipal Code. MSD makes annual employer contributions based on a percentage of the salaries of all members. The contribution rate for 1997 was 18.90%.

The City System has 5,896 active contributing participants of which 666 are MSD employees. For 1997 MSD's contribution was 17 percent of the total employer contribution.

The following significant actuarial assumptions used for 1997 and 1996 to compute the pension benefit obligation are the same as those used to compute actuarial determined contribution requirements.

- | | |
|----------------------------|---|
| 1. Investment Return: | 8.75% prior to the deduction of expenses per annum, compounded annually and adding an expense assumption to the determination of the plan's normal cost. |
| 2. Mortality: | a) Non-disabled - 1983 Group Annuity Mortality Table.
b) Disabled - Pension Benefit Guarantee Corp. Disabled Mortality Table. |
| 3. Salary Scale: | 4.25% per annum for projected salary in 1996 and 4.5% thereafter with select rates during the first three years of service plus provision for an additional 9% increase in final average salary due to final lump sum salary payment. |
| 4. Rate of Termination: | 1995 City of Cincinnati Experience Table. |
| 5. Rate of Disability: | 1995 City of Cincinnati Experience Table. |
| 6. Asset Valuation: | Preliminary actuarial value of assets is calculated by projecting the prior year's actuarial value to the current valuation date using the valuation interest assumption and actual contributions, benefit payments and expenses. This preliminary value is then adjusted if it is not within a corridor equal to 90%-110% of the market value of assets. |
| 7. Assumed Retirement Age: | Table of rates from age 47 to 70. |
| 8. Medical Benefits: | Current premium costs with projected increases of 7% per annum for post retirement benefit increases. |

The "entry age normal with frozen initial liability" is the funding method used by the actuary in computing the employer contribution rate and estimated actuarial liability of the system. There was no unfunded actuarial liability at December 31, 1997.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI

NOTE 9 - PENSION AND RETIREMENT (Continued)

The City of Cincinnati Retirement System is considered part of the City of Cincinnati's financial reporting entity and is included in the City's financial report as a pension trust fund, a copy of which may be obtained from the City's Finance Director at 801 Plum Street, Cincinnati, OH 45202.

Other Postemployment Benefit Information

The City System provides hospital and surgical insurance to retired members who have earned fifteen years credited service at the time of termination or terminate after age sixty with five years credited service. Those who are receiving survivor benefits of eligible members are entitled to have their hospital and surgical insurance premiums paid by the System. When benefits would be reduced by reason of the retired member's eligibility for hospital and medical benefits under federal social security laws, the System will pay whatever additional fees are required for the federal medical coverage.

The health care coverage provided by the City System is considered an Other Postemployment Benefit (OPEB). It is advance funded on an actuarial determined basis as a portion of the employer contribution requirement to the System. The Cincinnati Municipal Code provides authority for employer contributions.

Public Employees' Retirement System

MSD has 24 employees, as of December 31, 1997, who are participants of the Public Employees' Retirement System administered by the State of Ohio. This plan is not a significant portion of the overall operations of MSD. Additional disclosures concerning this plan, including other postemployment benefit information, can be found in the plan's annual financial statements.

NOTE 10 - RELATED PARTY TRANSACTIONS

Cincinnati Water Works provides billing and collection services on customers' accounts for MSD. Fees for these services for 1997 and 1996 were \$3,292,000 and \$3,057,000, respectively. Fees are also paid to other municipalities and villages within Hamilton County for collection of sewerage bills.

The City of Cincinnati provides "overhead" services to MSD, such as check disbursement, investment and legal services, etc. The fees for these services for 1997 and 1996 were \$2,289,000 and \$2,177,000, respectively. In addition, the City's Municipal Garage provides gasoline and repairs vehicles for MSD. Fees for these services were \$877,000 and \$935,000 for 1997 and 1996, respectively.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

The City of Cincinnati and the Board of County Commissioners of Hamilton County, Ohio, are parties to a Federal Consent Order which was entered in settlement of United States of America vs. The Board of County Commissioners of Hamilton County, Ohio, et al., Case No. C-1-85-0693. The City and County have continued in their efforts to negotiate an amendment to change certain construction schedules appearing in exhibits to that order. The City and County believe these changes are due to circumstances beyond the control of either, and are seeking approval of those schedule modifications from the United States Environmental Protection Agency. The consent order provides for stipulated penalties for failure to meet certain construction schedule deadlines but specifically contemplates that no such penalties will be collected from either defendant where the non-compliance was beyond the reasonable control of the defendants. In addition, according to MSD's Chief Legal Counsel, EPA has requested the payment of \$290,000 in stipulated

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI

NOTE 11 - COMMITMENTS AND CONTINGENCIES (Continued)

penalties under the Consent Order for certain effluent limit excursions. The Consent order provides for stipulated penalties under certain conditions, and although the City and County have argued that no substantial penalties are appropriate, it appears that EPA does intend to extract some monetary payment for the excursions. Currently, the City is awaiting EPA's response to certain defenses presented during 1992.

As part of the District's capital improvement program the District has entered into a number of contracts for construction, design, and other services. Commitments under these contracts aggregate approximately \$26 million as of December 31, 1997.



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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

The Honorable Board of County Commissioners
The Metropolitan Sewer District of Greater Cincinnati
County of Hamilton, Ohio

We have audited the financial statements of The Metropolitan Sewer District of Greater Cincinnati (MSD), a component unit of the County of Hamilton, Ohio, as of and for the year ended December 31, 1997, and have issued our report thereon dated April 27, 1998. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether The Metropolitan Sewer District of Greater Cincinnati's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered The Metropolitan Sewer District of Greater Cincinnati's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

The Metropolitan Sewer District of Greater Cincinnati
Page Two

This report is intended for the information of the Hamilton County Board of Commissioners, the Auditor of the State of Ohio, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

VonLehman & Company Inc.

Fort Mitchell, Kentucky
April 27, 1998



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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE
WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM
AND INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

The Honorable Board of County Commissioners
The Metropolitan Sewer District of Greater Cincinnati
County of Hamilton, Ohio

Compliance

We have audited the compliance of The Metropolitan Sewer District of Greater Cincinnati (MSD), a component unit of the County of Hamilton, Ohio, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended December 31, 1997. MSD's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of MSD's management. Our responsibility is to express an opinion of MSD's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations,". Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about MSD's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on The Metropolitan Sewer District of Greater Cincinnati's compliance with those requirements.

In our opinion, The Metropolitan Sewer District of Greater Cincinnati complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 1997.

The Metropolitan Sewer District of Greater Cincinnati
Page Two

Internal Control Over Compliance

The management of The Metropolitan Sewer District of Greater Cincinnati is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered The Metropolitan Sewer District of Greater Cincinnati's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended for the information of the Hamilton County Board of Commissioners, the Auditor of the State of Ohio, and the cognizant federal audit agency. However, this report is a matter of public record and its distribution is not limited.

VonLehman & Company Inc.

Fort Mitchell, Kentucky
April 27, 1998